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SUBJECT: Argentina's New Federalism: Politicized Revenue Sharing with Provinces

Ref: Buenos Aires 976

Introduction and Summary

¶1. (SBU) Argentina's federal government collects the lion's share of national revenues, and a "co-participation" revenue-sharing scheme mandates that fixed shares of most federal taxes be distributed to the nation's 24 provinces. Controversial earmarks and other alterations to the distribution formula over time have charged public debate on Argentina's federalist model, and a 12-year-old constitutional mandate to negotiate a new revenue-sharing scheme remains unfulfilled. In part, this delay reflects the Kirchner administration's increasing reliance on new taxes not fully shared with provinces -- including new taxes on agricultural and hydrocarbon exports -- to support politically sensitive spending on national infrastructure projects. At the same time, growing supplementary and wholly discretional federal transfers to provinces have many Argentine analysts charging that the Kirchner administration is using provincial revenue distribution as a patronage tool to reward supporters and punish opponents. President Fernandez de Kirchner's remote home province of Santa Cruz receives the highest co-participation revenue distribution share relative to its population and the largest share of supplemental discretionary transfers relative to its base co-participation receipts.

¶2. (SBU) This cable is the first in a three-part series. It reviews the historical development of Argentine revenue sharing, and compares current co-participation distribution shares to provincial population and to provincial contributions to national GDP. Septels will consider current federal/provincial funding tensions in more detail as well as review the funding strategies of Buenos Aires, Argentina' largest province, to balance its own books. End Introduction and Summary.

Argentina Revenue Sharing: Historical Context

¶3. (SBU) Argentina's 1853 constitution established a federal republic in which provinces were granted considerable autonomy in administrative and fiscal matters. Despite this provincial autonomy, the bulk of consolidated government revenues in this era was generated by federal-level tariffs on imports, which accounted for roughly 90% of consolidated Argentine tax revenues. Provinces collected the remainder via consumption taxes. The 1853 constitution granted the federal government (GoA) the power to grant discretionary subsidies (Aportes del Tesoro Nacional, ATNs) to provinces with "fiscal imbalances" and such directed federal subsidy payments to provinces grew to over 60% of total GoA tax collection by the early 1900s. Historical data shows considerable temporal variations in the distribution of provincial ATN subsidies and, as a consequence, in individual provincial spending patterns.

¶4. (U) The first formal Argentine federal/provincial revenue sharing ("co-participation") regime was launched in the wake of the 1930 global economic crisis, as a dramatic fall in GoA's foreign trade tax collections prompted the creation of new domestic revenue generating vehicles, including federal income and federal sales taxes. Congress passed the currently effective co-participation Law in 1988 (see para 5). Subsequent 1996 amendments to Argentina's 1853 constitution required that a new co-participation agreement be developed and approved by Congress before January 1997, but this mandate has yet to be fulfilled.

¶5. (SBU) In the aftermath of Argentina's 2001/2 economic crisis, a 2003 IMF financing and restructuring agreement included conditionality requiring the GoA to meet its 1996 constitutional amendment mandate to negotiate a new co-participation agreement with provinces. However, in lieu of this, the IMF ultimately accepted congressional passage of the August 2004 Fiscal Responsibility Law (FRL), which imposed significant restrictions on the GoA's discretional use of budget funds. Subsequent enhancement of the GoA's "Superpowers" budget authority (federal power to unilaterally re-direct budget revenues with only nominal Congressional oversight) hollowed out the FRL. The GoA pre-paid US$ 9.5 billion in IMF borrowings in December 2005 and rejected any further IMF conditionality.

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Current Co-Participation Regime: The Labyrinth

¶6. (U) The 1988 Co-Participation Law (CL) established a list of federally collected taxes to be shared with the provinces. The GoA retains 42% of revenues generated, 57% is distributed among the provinces, and 1% is held in reserve "to finance unforeseen crises"

in the provinces. The main co-participable federal taxes are the Value Added Tax (VAT) and the Income Tax, which together accounted for 53% of total GoA tax revenues in 2007. Additional co-participable taxes include 30% of collections on the Financial Transactions Tax, some consumption taxes ("impuestos internos"), taxes on extraordinary profits, and taxes on interest income. Non-co-participable taxes include those on foreign trade (many of which are controversial export taxes - Ref A); taxes on insurance and on cigarettes; specific taxes directed to finance public fiduciary funds; and social security contributions.

¶7. (SBU) Notwithstanding the broad array of non-co-participable taxes, the 1988 CL law included a clause setting a floor distribution to provinces of 34% of total federal tax collections. In 1991, provinces received 46% of total federal tax collections, excluding contributions to the pay-as-you-go social security system. In sharp contrast, between March 2002 and December 2007, provinces received an average 31.9% of total federal tax collections, with a low in August 2002 of 23.4% and a high in June 2006 of 36.2%. After this 2006 peak, the distribution trend has again decreased, with provinces receiving an average of only 33% of total federal tax revenues in 2007. (Note: Some local analysts believe that a proper definition of "federal tax collections" should include worker contributions to the pay-as-you-go social security system. If these revenues are included in total federal tax collections, provinces received only 27% of the total in co-participation receipts in 2007.)

¶8. (SBU) The CL also set "secondary" distribution shares of co-participable federal revenues among Argentina's 24 provinces and federal capital district. Such secondary distribution, by general consensus, was to have been based on provincial population, population density, area, and level of development criteria, though no formal criteria or specific calculation methodologies were written into the CL. Since its 1988 inception, the CL has been supplemented by amendments regulating the distribution and destination of specific taxes and by a series of "fiscal pacts," including a 1994 pact which cut the proportion of revenues to be shared with provinces by 15% in order to finance national social security reform and privatization. (This 1994 reduction of provincial revenues is currently a topic of contentious debate in Congress as it representatives consider a controversial nationalization of the private pension system.)

¶9. (SBU) Additional supplemental GoA regulations have earmarked

shares of specific tax collections for specific spending obligations. For example, the wealth tax pool to be shared with provinces first subtracts US$1 million to finance the federal organ transplant agency. A share of federal income tax collection is set aside for Buenos Aires province (Argentina's largest) as an "automatic transfer" above and beyond the province's co-participation share. This mix of overlapping fiscal pacts and specific tax earmarks have complicated Argentina's revenue sharing system to the point that it is commonly referred to by local economic analysts as the "co-participation labyrinth."

Current Provincial Co-Participation Shares

¶10. (SBU) Current provincial co-participation shares display a notable gap between relative size (as measured by population and contribution to national GDP) and revenue sharing distributions. Argentina's largest province, Buenos Aires, is the clearest example. Despite holding 38% of Argentina's population and contributing some 34% of national GDP, Buenos Aires province received only 20% of total co-participation distributions in 2007. Similarly, the autonomous City of Buenos Aires, despite holding 8% of Argentina's population and contributing some 21% of national GDP, received only 1.9% of total 2007 co-participation distributions.

¶11. (SBU) Numerous local budget analysts justify this distribution on relative economic development grounds. They note that Buenos Aires province and Buenos Aires City are the nation's two wealthiest jurisdictions with the most highly developed economic infrastructure. Interestingly, President Fernandez de Kirchner's home province of Santa Cruz receives the single highest co-participation revenue distribution share relative to its population. The below table contrasts co-participation shares, percentage population, and percentage GDP contribution for a representative sample of 11 Provinces and the Federal Capital District.

Province	% Coparticipation Share 2007	% Population 2007 39.3 Million	% GDP 2007 US$261 Billion
Buenos Aires	20.1	37.9	34.4
City of BsAs	1.9	7.7	21.3
Cordoba	8.6	8.4	8.0
Formosa	3.5	1.4	0.6
Jujuy	2.8	1.7	1.0
Mendoza	4.1	4.4	4.3
Misiones	3.4	2.7	1.4
Rio Negro	2.5	1.5	1.3
San Luis	2.2	1.1	1.3
Santa Cruz	1.7	0.6	0.9
Santa Fe	8.8	8.2	8.4
¶S. del Estero	4.0	2.2	0.8

Source: Economy Ministry Secretariat of Political Economy Office for National Fiscal Coordination with Provinces

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Discretional Federal Transfers to Provinces

¶12. (SBU) The GoA has long supplemented formal co-participation payments to provinces with discretionary direct transfers. Local analysts note that such discretionary transfers have grown considerably since the implementation of federal "Superpower" budget authority following the 2001/2 economic crisis. This authority, which was recently renewed as a provision of the 2009 budget, allows the GoA to re-allocate budget revenues with minimal congressional oversight. Many analysts charge that such federal discretionary payments have been allocated as political patronage to reward supporters and punish opponents of the current administration.

¶13. (SBU) In 2007, co-participation funds of ARP 55.2 billion (roughly US$ 16.5 billion) were supplemented by ARP 12.7 billion ($3.8 billion) of discretionary GoA transfers. Notable here is the large share of discretionary payments made to Buenos Aires province (a ruling coalition stronghold) and the small share granted to the

City of Buenos Aires (which has traditionally voted in opposition to the Peronist party). Also notable is the outsized share of discretionary payments granted to the current and former presidents' home province of Santa Cruz (equivalent to 130% of its formal co-participation payments).

2007 Discretionary Transfers (DT)

Province	DT Received as % Total 2007 DT	DT Received as % of Co-Part Funds Rec'd
Buenos Aires	30.1	34.2
City of BsAs	1.8	20.9
Cordoba	8.2	21.8
Formosa	2.2	14.1
Jujuy	3.5	28.8
Mendoza	2.3	12.8
Rio Negro	1.1	9.9
San Luis	0.6	6.5
Santa Cruz	9.4	129.9
Santa Fe	5.6	14.6
¶S. del Estero	2.2	12.4

Source: Economy Ministry Secretariat of Political Economy Office for National Fiscal Coordination with Provinces

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Comment

¶14. (SBU) Argentina's "co-participation" federal revenue sharing scheme has been a perennial sticking point in federal/provincial relations. The GoA's 12-year delay in meeting its constitutional mandate to negotiate a new Co-participation agreement reflects federalist center/periphery tensions that have shaped much of Argentina's historical political development. Presently, the delay also indicates the Kirchner administration's preference for taxes not fully shared with provinces - including taxes on agricultural and hydrocarbon exports and on financial transactions - to support its discretional and politically sensitive spending on national infrastructure projects. The Kirchner administration's recent failed effort to impose a variable export tax regime led to a six-month long GoA confrontation with the agricultural sector "campo" that significantly weakened the administration's popularity. Governors routinely grumble about their dissatisfaction with the current revenue-sharing scheme and with the GOA's laxity in remitting funds to the provincial governments on a timely basis.

¶15. (SBU) Septels will review current federal/provincial funding tensions in more detail as well as review the funding strategies of Argentina' largest province, Buenos Aires province, to balance its own books.

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